
Investment forum explores Ukrainian market

by Khristina Lew

NEW YORK - For many foreign investors, the Ukrainian market continues to be uncharted terrain riddled by chaotic laws and corruption. Yet, a growing number are plunging in, with profitable results.

The Ukrainian-North American Investment Forum, held on January 29-30 at the Marriott Financial Center Hotel here, explored the possibilities and pitfalls of doing business in Ukraine and featured first-hand accounts from joint ventures such as UTEL and UKR-CAN Power.

The two-day forum attracted 125 investors from companies as diverse as Shell, Chrysler, KPMG and the International Finance Corp., and heard from Ukrainian officials from the Ukrainian Agency for Reconstruction and Development, the State Property Fund, the State Securities and Stock Market Commission, and the Embassy of Ukraine to the United States.

U.S. government presence was heavy, led by Ambassador Richard Morningstar, special advisor to the president and secretary of state on assistance for the NIS, and Jan Kalicki, U.S. ombudsman for energy and commercial cooperation with the NIS.

Conspicuously absent were the forum's top-billed speakers: Ukraine's reform-minded Vice Prime Minister for the Economy Viktor Pynzenyk, Chairman of the Ukrainian Agency for Reconstruction and Development Roman Shpek and Chairman of the State Property Fund Yuriy Yekhanurov.

Stephen Butler, producer of the forum, presented by the American Conference Institute-EuroForum, explained that all three were last-minute cancellations. Mr. Pynzenyk was asked to stay in the Ukrainian capital while Prime Minister Pavlo Lazarenko took a vacation. Mr. Shpek accompanied President Leonid Kuchma on a trip to Paris. Mr. Yekhanurov sent a deputy to speak on his behalf.

"It's disappointing that the Ukrainian side didn't send its ministers," said Maryna Hrushetska of EPIC, a European privatization and investment corporation that sponsored the forum. "It shows that Ukraine doesn't take courting private capital seriously."

According to many speakers at the conference, however, Ukraine has taken great strides to improve its investment climate. In 1996 the Verkhovna Rada passed a Constitution, the government achieved macroeconomic stabilization, and the interim currency, the karbovanets, was replaced with the hryvnia.

The State Property Fund introduced compensation certificates and began holding state certificate auctions. According to Natalia Prokopovich, director of the Investment Department at the State Property Fund, since the beginning of last year, the SPF has offered 290 share packages of enterprises, with an over-all face value of \$60 million, for sale at commercial and non-commercial tenders. The SPF is also readying 222 enterprises of strategic value for the Ukrainian economy, the "crown jewels," for sale at non-commercial tenders.

On the flip side, investors in the Ukrainian market still face many hurdles. The judiciary is not well established, corruption is an extremely serious issue, there is no mechanism to resolve investment disputes, and the Verkhovna Rada has yet to pass a legislative package designed to reform the economy, promote foreign investment, and reduce the tax burden on domestic and foreign investment.

Estimates place between 40 percent and 50 percent of the Ukrainian economy in the gray area, but Dr. Peter Goldscheider, managing director of EPIC, claims that this is a necessary developmental step for Ukraine. "In my view, the Dnipropetrovsk mafia is rubbish. We shouldn't tie this with corruption," he said.

In recent years, total foreign investment in Ukraine amounts to \$1 billion, with the United States leading the pack with \$250 million. A large percentage of foreign investment, according to Dr. Goldscheider, comes from Cypress, Swiss bank accounts and the return of flight money.

Success stories

Foreign investors attempting to launch joint ventures in Ukraine tell horror stories about confusion and corruption at the highest levels of government over policy and implementation. Stewart Reich, president of UTEL, a joint venture between AT&T, Deutsche Telekom, PTT Telecom (the Netherlands) and Ukrainian telecommunications entities, readily admits that UTEL benefited from the government's chaotic practice of licensing.

Four years ago UTEL entered the Ukrainian market with 20 employees, and has thus far invested a total of \$100 million. Today, 1,500 employees operate and maintain a long-distance and international switching network that generated over \$250 million in revenues in 1996.

Mr. Reich advises potential investors to be patient and pointed out that with 30 percent of all foreign investments in Ukraine occurring in the first six months of 1996, the country's investment climate has improved dramatically. "Ukraine is a good place to invest, but it is not an easy place to invest," he said.

In the energy sector, Northland Power of Calgary formed a joint venture called UKR-CAN Power with the State Property Fund and the Darnytsia Heat and Power Plant, making Northland Power the largest private investor in the Ukrainian electrical energy sector. UKR-CAN Power will reconstruct the Darnytsia plant facilities with an investment of over \$110 million.

Ed Southern, chief executive officer of UK-RAN Oil Corp. of Calgary, reminded investors that Ukraine has tremendous oil and gas potential which has yet to be exploited. Ronald Cormick, president of Epic Energy in Calgary, said Ukraine can be a net oil exporter in five to 10 years.

Perhaps the greatest success story in Ukraine involves a Ukrainian commercial bank, Privatbank. Created in March 1992, the Dnipropetrovsk bank today has 144 branches in Ukraine, one bank in Moscow, and is considered the 14th largest bank in Belarus. It is the first bank in Ukraine to issue credit cards, and according to Serhiy Tigipko, the bank's chairman of the board, it issues 1,000 new credit cards every month. The bank has worked with the European Bank for Reconstruction and Development, is a member of the Visa Europe network and last year received credit lines.

Privatbank also allows customers to open anonymous numbered accounts. The 30-something Mr. Tigipko said that 30 billion to 40 billion hryvnia (about \$15.96 billion to \$21.28 billion U.S.) of flight capital has returned to Ukraine through Privatbank's numbered accounts.

Investment banks such as Creditanstalt Investment Bank in Vienna, Credit Suisse First Boston and Kinto Investments & Securities in Kyiv, a sponsor of the forum, have had some measure of success in trading Treasury bills and compensation certificates.

Anton Janes, director of corporate finance at Creditanstalt Investment Bank, noted that only a small number of compensation certificates has been obtained by the population, and an even smaller number has been invested. The Ukrainian government has extended the privatization voucher deadline until the end of 1997, 40 percent of which have not been invested, he said.

Alexander Knaster, managing director of Credit Suisse First Boston in Moscow, pointed out some of the risks of investing in Ukraine - the budget may be delayed by the Verkhovna Rada, the government has accumulated wage and pension arrears, and relies too heavily on the International Monetary Fund, Ukraine's equity market is pre-emerging compared to Eastern Europe - but predicted that 1997 will be the year of rapid and steep growth of securities because privatization will be completed.

Both government officials and investors already in the country recommended that potential investors work with a Ukrainian partner whom they have chosen very carefully, document their activity and stay involved in the venture. Ambassador Morningstar advised setting limits and cautioned against "falling down the slippery slope of corruption."

U.S./Canadian government support

The U.S. government demonstrated its commitment to Ukraine's economic development by sending high-level representatives of the State Department and the Overseas Private Investment Corp. to the Ukrainian-North American Investment Forum.

Ambassador Morningstar emphatically stated at the outset of the forum that "There is no higher priority in U.S. foreign policy than to see Ukraine become an independent and stable market economy." He noted that U.S. energies are focused on bolstering Ukraine's economic reforms and pointed out that two committees of the Kuchma-Gore Commission - Sustainable Economic Cooperation, and Trade and Investment - relate to Ukraine's economic well-being.

Mr. Kalicki, who attended the January meeting of the Committee on Trade and Investment held in Kyiv, said the committee will create a Subcommittee on Business Facilitation that will act as a channel for resolving disputes involving American firms.

The Canadian government has set up a similar commission to serve as the front line to addressing issues so that investment projects will not suffer the long delays associated with doing business in Ukraine.

The Canadian government's perspective on investing in Ukraine was outlined by Bohdan Onyschuk, managing partner of Smith Lyons, who led the first Canadian trade mission to Ukraine in 1989. Lloyd Axworthy, Canadian minister of foreign affairs, was scheduled to attend the forum but canceled due to an official trip.

Gerald Fedchun, president of the Canada-Ukraine Chamber of Commerce, detailed last year's Canadian trade mission to Ukraine, which delivered deals worth \$600 million and will make Canada the premier investor in Ukraine.

Most investors at the two-day forum agreed that the value of conferences such as these is gleaned from new information and making contacts. George Carivalis of Caspian Asset Management in New York and London, a firm that is considering investing in Ukraine, said, "We lacked information about the Ukrainian market and we're curious - there is a lot of surplus cash looking for a home in markets like Ukraine."

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